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1031 Exchanges benefit businesses by allowing them to stay profitable in competitive markets

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A great many business transactions entail solely personal property transfers or have a personal property component attached. "Personal property" should not be confused with "personal use property" that refers to an asset used for the personal enjoyment of the taxpayer. Rather, "personal property" refers to all property, both tangible and intangible, that is not considered real property.

Business-use personal property assets may include machinery, manufacturing equipment, construction equipment, fishing vessels, charter boats, aircraft, trucks, artwork and collections, as well as intangibles such as distribution routes, franchise licenses, copyrights and patents.

Taxpayers selling multiple-asset property such as hotels, restaurants or gas stations often structure several exchanges to separately accommodate the real property and personal property components. Generally owned under different entities, the deferred gain and basis calculations may be different. Note that goodwill is not exchangeable.

Why would you consider a 1031 Exchange on an asset for which the value at sale is considerably less than its original purchase price? Surprisingly, many types of business-use assets can be fully depreciated in as little as 3, 5 or 7 years, resulting in an asset with a very low adjusted basis, even possibly a zero tax basis. When that asset is sold, tax on the amount subject to depreciation recapture can be substantial - upwards of 35%!

Therefore, utilizing Section 1031 preserves cash flow, providing businesses the means to reinvest and upgrade to more productive, energy efficient like-kind property. This allows them to stay profitable in competitive markets and in turn, this purchase power helps to stimulate the economy of related business sectors.

Unlike real estate exchanges, where the like-kind term is rather flexible on qualifying property, the 1031 Regulations for personal property are more limiting: "like-kind" actually does mean like kind. Depreciable tangible personal property must be "like-kind" or "like-class", following the same General Asset Class or Product Class. Intangibles depend on the "nature or character of rights involved" and the "nature or character of the underlying property to which the intangible personal property relates". For instance, a copyright on a novel is like-kind to a copyright on a novel but is not like-kind to a copyright on a song.

Depreciation recapture is the main motivation for structuring 1031 Exchanges with tangible business-use assets. This ability to defer tax encourages growth and allows owners to keep that money working for them, rolling it back into their business.

Due to the varied nature of businesses and personal property as a whole, these exchanges are best handled by an experienced Qualified Intermediary in conjunction with the taxpayers' tax and legal advisors.

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